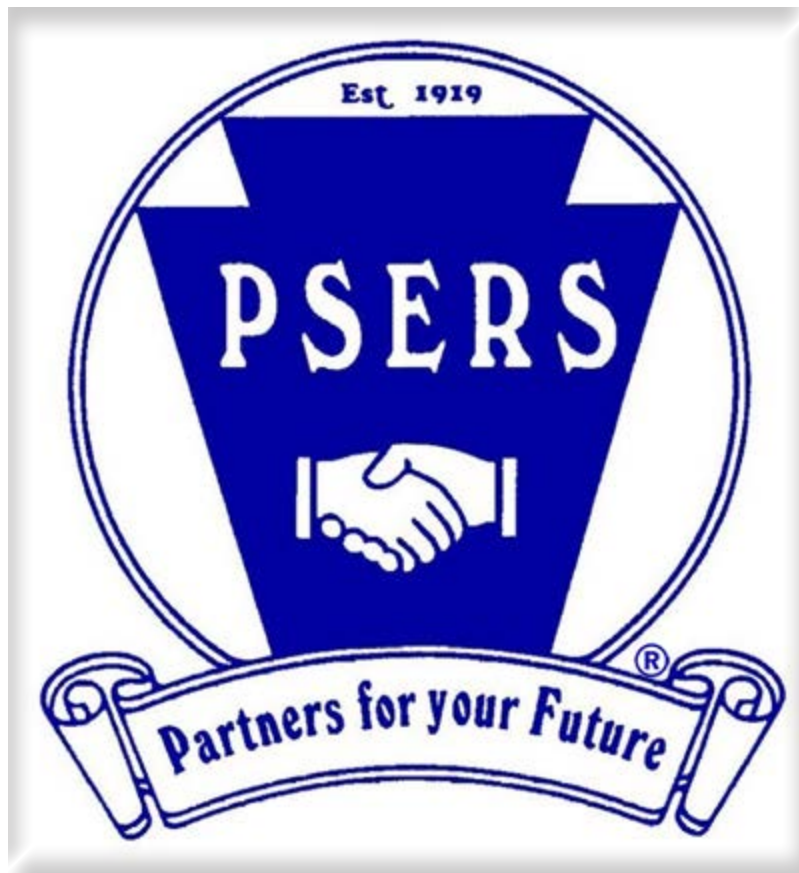


Section 1 - PSERS Overview





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Overview

Established on July 18, 1917, with operations commencing in 1919, the Pennsylvania Public School Employees' Retirement System (PSERS or System) provides retirement benefits to public school employees of the Commonwealth of Pennsylvania.

As of June 30, 2013, the System had approximately 267,000 active members. The annuitant membership was comprised of approximately 209,000 retirees and beneficiaries who received average monthly pension benefit payments of over \$435 million including healthcare premium assistance. The average yearly pension benefit paid to annuitants was \$24,603. PSERS had 797 participating employers on June 30, 2013.

As reported in the latest Pension and Investments survey, published February 3, 2014, PSERS is the 29th largest plan among United States corporate and public pension plans, and the 19th largest state-sponsored defined benefit public pension fund in the nation. PSERS' total plan net assets as of December 31, 2013 were approximately \$50.4 billion.

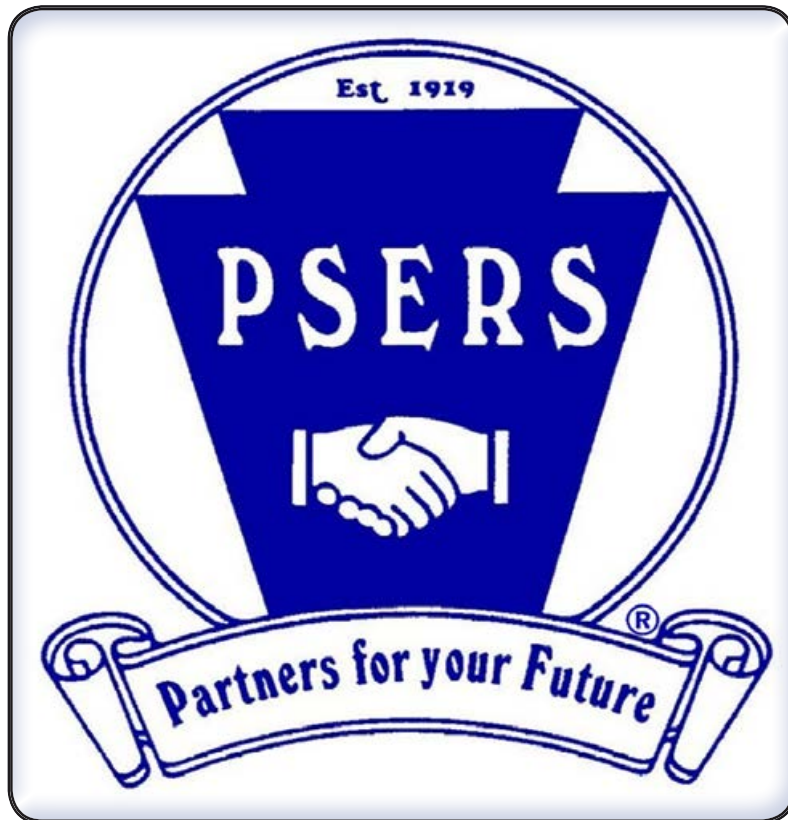
During calendar year 2013 the overall gross distribution of pension and postemployment healthcare benefits including monthly benefits, direct rollovers, survivor benefits and refunds totaled \$6.0 billion. Of this amount, 91% was distributed to Pennsylvania residents representing PSERS' significant impact on the Commonwealth's economy.

Mission Statement

The Board of Trustees and the employees of the Public School Employees' Retirement System serve the members and stakeholders of the System by:

- Providing timely and accurate payment of benefits,
- Maintaining a financially sound System,
- Prudently investing the assets of the System,
- Clearly communicating members' and employers' rights and responsibilities, and
- Effectively managing the resources of the System.





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PSERS Board of Trustees

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James M. Sando, Vice Chairman

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Honorable Glen R. Grell
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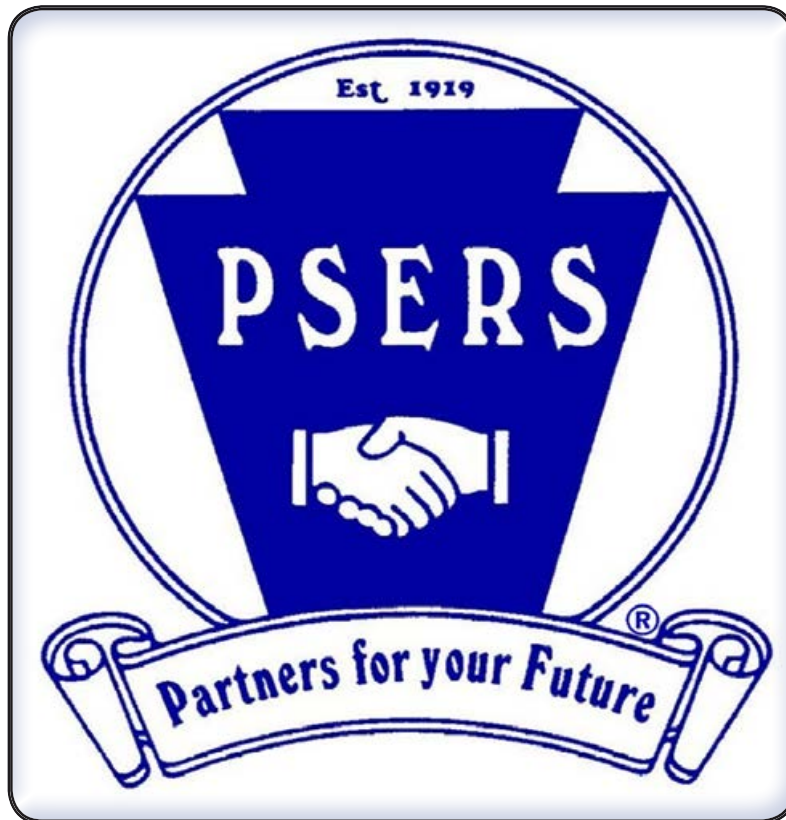
Nathan G. Mains

Honorable Joseph F. Markosek
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Honorable Robert M. McCord
Treasurer of Pennsylvania

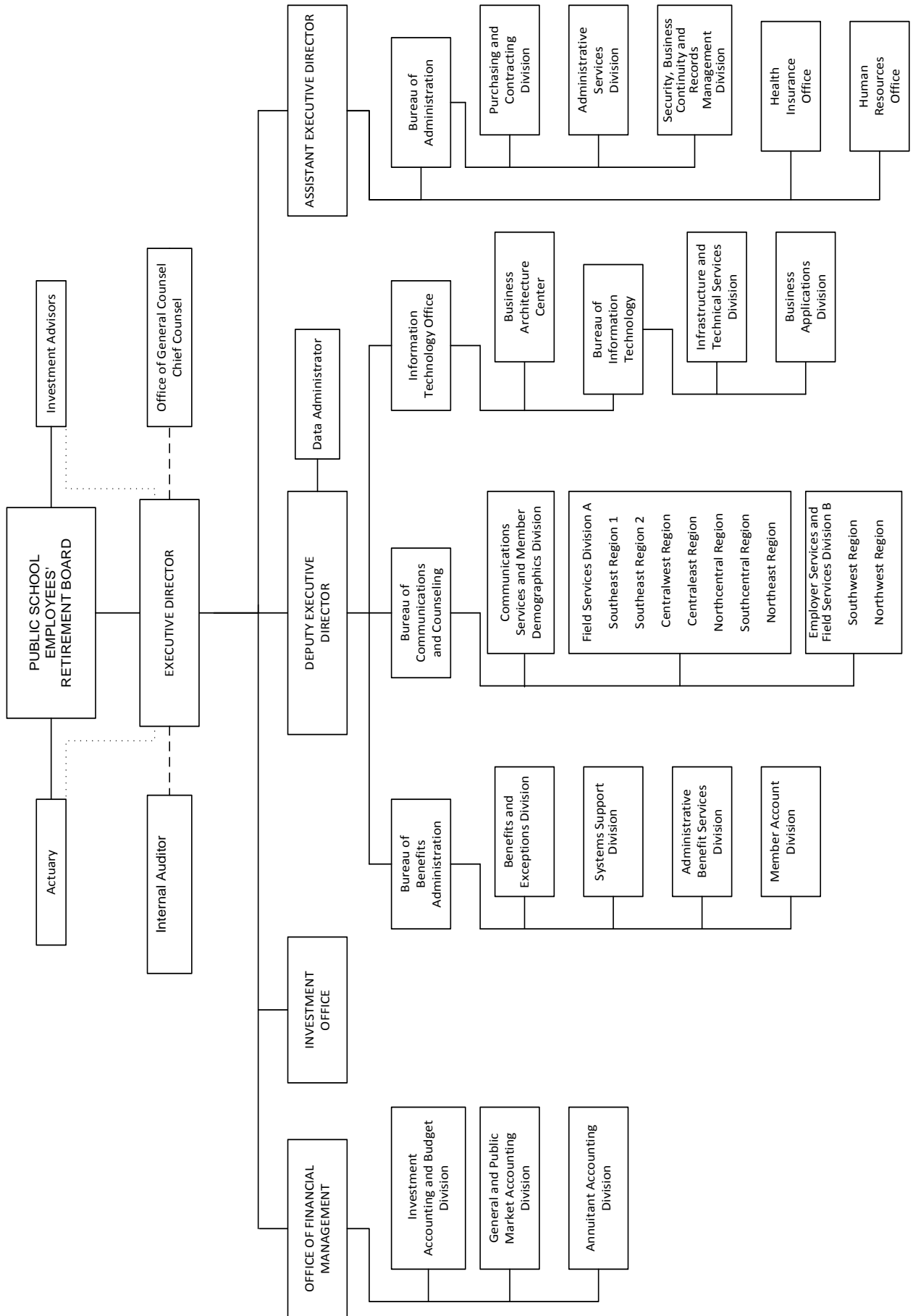
Ambassador Martin J. Silverstein

PSERS Board Members as of January 23, 2014



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Organizational Chart of the
Public School Employees' Retirement System



Organizational Structure of the Public School Employees' Retirement System

Executive Office

This office is responsible for the overall management of the Public School Employees' Retirement System (PSERS) to achieve the primary objectives of the Fund as established by the Board of Trustees (Board). Reporting directly to the Executive Director is the Deputy Executive Director, Assistant Executive Director, Chief Investment Officer, Chief Financial Officer, Internal Auditor, Press Secretary, Board Liaison, and Legislative Liaison. The Executive Director serves as chief executive officer responsible for the establishment, installation, and maintenance of modern management techniques to provide an efficient control of funds for and services to the active members and annuitants of the System.

The Executive Office monitors the operation of the investment portfolio and evaluates portfolio performance for consideration by the Board, certifies expenditures of the Fund and measures performance of professional individuals or firms with whom the Board contracts for specialized services. The Executive Office also appraises the Board of any development that will in any way affect the System and its operation.

Investment Office

This office is responsible for the investment activities of the System. In compliance with the investment policy established by the Board, PSERS' investment assets are allocated to numerous outside professional investment advisors and internal investment professionals.

Chief Counsel's Office

This office provides legal services through a team of professional personnel under the Governor's Office of General Counsel. The legal staff is responsible for representing the System in all administrative hearings and other litigation matters and providing counsel in a wide variety of matters including the interpretation of the Retirement Code, form and legality of all System contracts, corporate governance issues and the structure and implementation of the System's varied financial investments.

Internal Auditor's Office

This office performs systematic reviews of the various activities of PSERS, testing for compliance with applicable laws, policies and procedures. The Internal Auditor makes recommendations on the improvement of the System's internal control system.

Office of Financial Management

This office is directed by the Chief Financial Officer and has responsibility for planning, organizing and directing a complete accounting and financial reporting system in conformance with accounting principles generally accepted in the United States of America. Oversight is provided for new systems development and maintenance of existing systems, and ensuring appropriate accounting controls. The office is the liaison for other state and federal agencies, reporting units, financial consultants, actuaries, and investment advisors for all accounting, treasury operations, taxation, actuarial and budgetary matters. The office is organized into three divisions: General and Public Market Accounting Division, Annuitant Accounting Division, and Investment Accounting and Budget Division.

General and Public Markets Accounting Division

This division has the responsibility of recording all financial transactions for the pension and health care operations of the System. It maintains PSERS' General Ledger and prepares interim financial statements and is responsive for overseeing the preparation of PSERS Comprehensive Annual Financial Report. It bills and collects contributions due to the Fund from its employers. It provides accounts receivable services to the System for member debts. It also interacts with the other units in the Office of Financial Management to assure that the basic financial statements of the System include all financial activity monitored and controlled by those areas. This division is responsible for directing and administering the Foreign Cash Overdraft and Foreign Tax Reclaim Collection programs as part of PSERS' investment activities. Working with the assistance of a third-party application service provider, it has the responsibility for monitoring the overall internal control structure for public market investments thereby assuring adequate custody of all Public Market investment assets.

Annuitant Accounting Division

This division is responsible for the mission-critical annuitant payroll and disbursement function. The division also has the responsibility of monitoring and recording post-employment healthcare transactions. It reconciles and monitors the financial activities of the third party administrator of the Health Options Program.

Investment Accounting and Budget Division

This division serves as intermediary with the custodian bank, the State Treasury Department, brokers, investment managers, the investment evaluator, and investment consultants. The division processes, audits and approves investment expenses, prepares monthly investment financial reports and processes all investment funding allocations. Working with the assistance of a third-party application service provider, it has the responsibility for monitoring the overall internal control structure for investments thereby assuring adequate custody of all non-Public Market investment assets.

Organizational Structure (continued)

The division is also responsible for directing and administering the Class Action Revenue Recovery program as part of PSERS’ investment activities. It also supports PSERS’ Investment Office and the Board in achieving investment objectives and monitoring compliance with investment policy. Additionally, the division is responsible for developing and monitoring the System’s annual budget.

Deputy Executive Director’s Office

The Deputy Executive Director directly oversees the benefit programs for all active and retired members of the System, the development and implementation of the member and employer communications programs and the member counseling programs, and the maintenance of agency policies, procedures, and benefit related data. Additionally, this position oversees business and information technology strategic planning, policy development, and implementation.

Bureau of Benefits Administration

The Bureau of Benefits Administration maintains account data, determines membership and benefits eligibility, and calculates benefits for Pennsylvania public school employees. This bureau provides these functions for all benefits provided by PSERS, except the PSERS Health Options and Premium Assistance Programs.

Benefits and Exceptions Division

This division is responsible for the timely and accurate processing of benefits, including all regular and disability retirements, post-retirement adjustments, death benefits, account valuations, domestic relations orders, and worker’s compensation calculations.

Systems Support Division

The Systems Support Division provides key analytical services to the bureau and to other bureaus within the organization including specific services such as research, analysis, recommendations for action, and implementation support related to PSERS’ information systems, data, or business or management processes.

Administrative Benefit Services Division

This division provides administrative support services to the bureau and manages the first level of the member appeals process. Additionally, the division provides quality assurance for data integrity and benefit calculations.

Member Account Division

The Member Account Division ensures that member account data is accurate and complete throughout the entire lifecycle of the member and serves the needs of our members, agency staff, employers, and PSERS actuaries. This critical data is used, among other things, to determine

eligibility for, calculate, and pay benefits for PSERS members and as input in the determination of employer contribution rates and actuarial assumptions. As part of maintaining member accounts, in addition to maintaining and verifying the accuracy of account data, this division processes multiple service elections, purchases of service, account adjustments, and refunds of contributions and interest.

Bureau of Communications and Counseling

The bureau provides services to educate and inform annuitants, members, employers, staff and the public about the benefit related programs and services provided by PSERS, as well as the rights and duties of employers and members in relation to those benefits. Information communicated spans from very detailed and fact-specific explanations and instructions to more general explanations and educational materials.

Communications Services and Member Demographics Division

This division handles general inquiries primarily via telephone and other electronic mediums about the many benefits and processes of PSERS as well as specific inquiries related to a member’s account and the functions related to the initial entry of a member into the retirement system. The division also provides for the production and publication of newsletters, handbooks, pamphlets, mass communications to the membership, and agency websites, and ensures that outgoing member and employer letters are written to ensure ease of comprehension and compliance with agency standards.



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Organizational Structure (continued)

Field Services Division A

This division is responsible for the majority of PSERS' regional offices defined as Division A to provide comprehensive services to both active and retired PSERS' members and their associated affiliates in PSERS' regional offices located throughout the Commonwealth of Pennsylvania. This includes the calculation of retirement benefit estimates, benefit counseling sessions with members to explain estimated retirement benefits, retirement options, death and survivor benefits, and other benefits issues, to assist members in understanding their retirement related decisions, and to respond to a variety of requests and inquiries regarding member accounts.

Employer Services and Field Services Division B

This division provides comprehensive services to employers, including technical training and workshops on PSERS complex business rules and on the use and operation of the web-based reporting system used by employers to communicate member data to PSERS. The division is also responsible for some PSERS' regional offices defined as Division B to provide comprehensive services to both active and retired PSERS' members and their associated affiliates in PSERS' regional offices located throughout the Commonwealth of Pennsylvania.

Information Technology Office

This office oversees the Bureau of Information Technology and the Business Architecture Center. It is responsible for strategic information technology planning and policy development, ensuring that information technology plans, projects and policies are aligned with, in support of, and prioritized according to agency needs and requirements as well as those Commonwealth needs and requirements that are consistent with agency needs, and for communicating such to the agency's IT staff. Large information technology contracts and projects are managed by this office. This bureau is responsible for understanding, analyzing, documenting, and improving PSERS' processes, information systems, and the relationships among these components so that PSERS is able to: conduct its business consistently and according to established rules; understand each component, its relationship to each of the other components and to PSERS' mission, vision, values and goals; fully, yet quickly analyze and understand the impact of potential change to one or more of these components on the others; more effectively identify inefficient, duplicate, or suspect processes, technologies; account for its processes, information systems and technologies.

Business Architecture Center

This center serves as the repository for PSERS' business knowledge and makes that knowledge available and understandable to agency processing and technology staff. The center receives and responds to data queries from agency staff and investigates system, data, or process problems. This center includes staff who collect, analyze,

and document PSERS' processes, information systems and data, and perform detailed impact analysis as and when change is proposed. Additionally, staff in this unit coordinate, lead, and track projects and confirm that changes have been applied correctly. They look for opportunities for improvement, lead the development of business requirements, and serve as liaisons between PSERS' end-users and Information Technology staff.

Bureau of Information Technology

This bureau is responsible for planning, coordinating, administering, and implementing information technology resources in accordance with the agency's strategic plans, goals, objectives, and priorities as communicated by PSERS' Chief Information Officer, and for providing operational support for those technologies and initiatives.

Infrastructure and Technical Services Division

This division is responsible for administering those information technology resources that collectively provide the fundamental hardware, software, security, network components and services required to support PSERS various applications.

Business Applications Division

This division provides consultative, technical, and operational support in the planning, design, specification, configuration, development, implementation, interfacing, operation, support, and troubleshooting of PSERS' business applications.

Assistant Executive Director

This position reports to the Executive Director and may provide assistance to the Executive Director on agency-wide projects. The position administers the Health Options and Premium Assistance Programs in addition to the facilities, human resources, and procurement activities necessary to support, secure and optimize agency operations. Organizational units overseen by the Assistant Executive Director include the Bureau of Administration, the Human Resources Office, and the Health Insurance Office.

Bureau of Administration

This bureau provides facilities, purchasing and contracting, policies and procedures, business continuity, records management, automotive, mail, imaging, and other administrative services necessary to support agency functions.

Purchasing and Contracting Division

This division procures materials, supplies, and services needed to support organizational goals and develops, monitors, processes and evaluates contract usage in the agency.

Administrative Services Division

This division manages building and grounds for the agency both at headquarters and at the regional locations, provides mail, imaging services to the agency, asset management and other administrative services to the agency.

Section 1 - PSERS Overview

Organizational Structure (continued)

Security, Business Continuity, and Records Management Division

This division develops and implements those policies, programs and procedures necessary to ensure that PSERS' technology, and capital resources are secure and to ensure that PSERS is prepared to quickly recover and continue critical operations in the event of a disaster. The division also maintains office safety and health programs responsibility for managing PSERS' electronic data records, imaged records, paper and film/fiche records.

Human Resources Office

This office is responsible for supporting management and staff to facilitate the accomplishment of the agency's mission. It administers all human resources programs and ensures compliance with labor law and Commonwealth regulations. Programs include position classification, labor relations, recruitment and placement, employee benefits, employee compensation and pay, training and

staff development, time and attendance, performance management, organizational development and support, employee transactions, Equal Employment Opportunities and other miscellaneous programs.

Health Insurance Office

This office is responsible for all aspects of the PSERS' Health Options Program (HOP) and administering the PSERS annuitant health insurance premium assistance benefits. HOP is a voluntary statewide plan that provides group health insurance coverage for school retirees, their spouses, and eligible dependents.

PSERS Regional Offices

There are eight PSERS Regional Offices strategically located throughout the Commonwealth. The offices provide services to both active and retired PSERS members and 797 employers. Among these services are regularly scheduled retirement counseling meetings and other informational presentations on various topics relating to retirement benefits and programs.

Benefits Processed (Major Processes)		
Calendar Year	2012	2013
Initial Retirements (1-Step)	8,715	11,081
Initial Retirements (2-Step)	1,819	1,230
Final Retirements (2 nd Step of 2-Step)	2,241	1,308
Purchases of Service and Corrections for Previously Unreported Service and/or Contributions not Withheld	21,938	18,951
Refunds	5,133	4,728
Deaths	9,157	7,890
Account Verification - non retirements	9,356	10,211
TOTAL	58,359	55,399
Percent of Retirement Paid as 1-Step	83%	90%

Other Member Services (Major)		
Calendar Year	2012	2013
Estimates	18,671	25,370
Phone Calls Answered	228,229	267,804
E-mails Received	14,920	16,164
E-mails Sent	12,105	12,298
General Information Sessions	187	201
General Information Attendees	10,604	13,665
Exit Counseling Sessions	874	983
Exit Counseling Attendees	7,498	8,962

PSERS REGIONAL OFFICES

Public School Employees' Retirement System of Pennsylvania
PSERS FIELD SERVICES DIVISION
Serving You in the 21st Century

NORTHWEST
 Suite C, Penn Wood Center
 464 Allegheny Blvd.
 Franklin, PA 16323-6210
 Local (814) 437-9845
 FAX (814) 437-5826
Toll Free 1-888-773-7748 ext. 5175
 Donald Gregory, Administrator

NORTHCENTRAL
 Suite 201
 300 Bellefonte Avenue
 Lock Haven, PA 17745-1903
 Local (570) 893-4410
 FAX (570) 893-4414
Toll Free 1-888-773-7748 ext. 5275
 Jeremy Wibbe, Administrator

NORTHEAST
 Suite 201
 417 Lackawanna Avenue
 Scranton, PA 18503-2013
 Local (570) 614-0269
 FAX (570) 614-0278
Toll Free 1-888-773-7748 ext. 5375
 Sherry L. Hoxie, Administrator

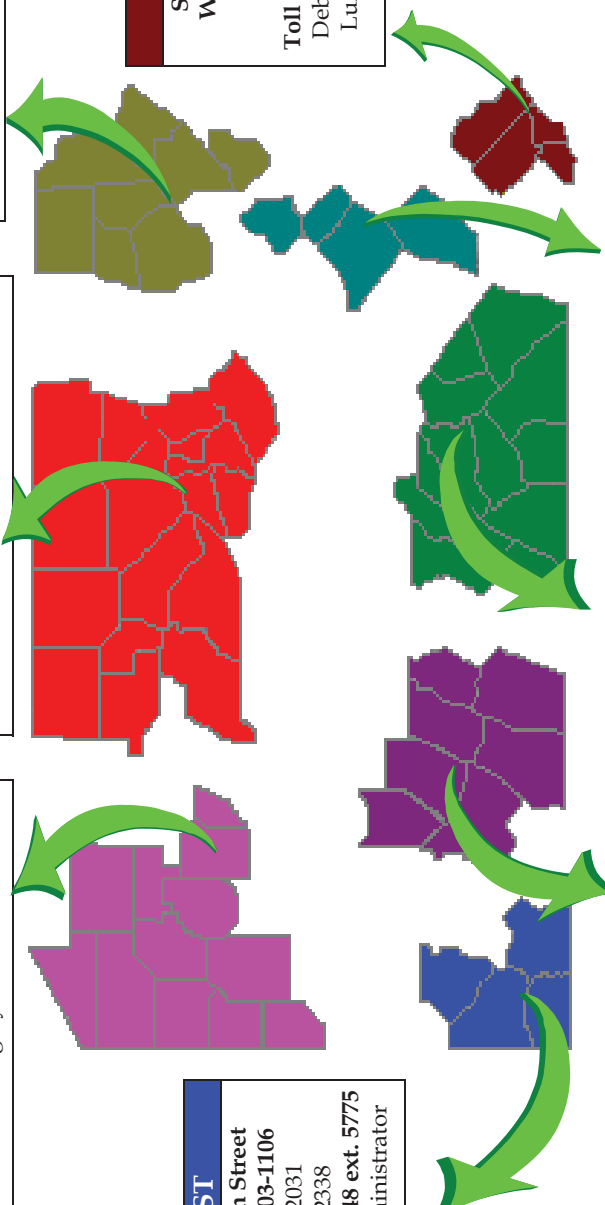
SOUTHWEST
 Suite 208, 900 Sarah Street
 Pittsburgh, PA 15203-1106
 Local (412) 488-2031
 FAX (412) 488-2338
Toll Free 1-888-773-7748 ext. 5775
 Russell J. Miller, Administrator

SOUTHEAST
 Suite 500, 605 Louis Drive
 Warminster, PA 18974-2825
 Local (215) 443-3495
 FAX (215) 443-3487
Toll Free 1-888-773-7748 ext. 5575
 Deborah Puskas, Administrator
 LuAnn Rowan, Administrator

CENTRALWEST
 219 W. High Street
 Ebensburg, PA 15931-1540
 Local (814) 419-1180
 FAX (814) 419-1189
Toll Free 1-888-773-7748 ext. 5875
 Brian Farester, Administrator

SOUTHCENTRAL
 5 N 5th Street
 Harrisburg, PA 17101-1905
 Local (717) 720-6335
 FAX (717) 783-9606
Toll Free 1-888-773-7748 ext. 6335
 Mary James, Administrator

CENTRALEAST
 Suite 103, 110 West Arch Street
 Fleetwood, PA 19522-1321
 Local (610) 944-9113
 FAX (610) 944-9275
Toll Free 1-888-773-7748 ext. 5475
 Lisa A. York, Administrator



Section 1 - PSERS Overview

PSERS' Member Demographics and Economic Information (continued)

Fiscal Year ended <u>June 30</u>	Members by Type					Ratio of Active/ Retired	Total Inactive, Active & Survivor Annuity
	Active Members	Inactive Members	Annuity, Beneficiaries, and Survivor Annuity	Total Active/Retired Members			
2013	267,428	128,650	209,204	476,632	1.28 to 1	605,282	
2012	273,504	122,286	202,015	475,519	1.35	597,805	
2011	279,152	115,102	194,622	473,774	1.43	588,846	
2010	282,041	111,931	184,934	466,975	1.53	578,906	
2009	279,701	103,805	177,963	457,664	1.57	561,469	
2008	272,690	100,803	173,540	446,230	1.57	547,033	
2007	264,023	109,186	168,026	432,049	1.57	541,235	
2006	263,350	94,071	161,813	425,163	1.62	519,234	
2005	255,465	58,720	156,519	411,984	1.63	470,704	
2004	247,901	72,014	151,552	399,453	1.63	471,467	
Average ratio of annuities to active members (Public Funds)					1.65*		

*Based on the December 2013 Public Fund Survey prepared by the National Association of State Retirement Administrators (NASRA).

Profile of PSERS' Annuity, Beneficiaries, and Survivor Annuity				
Type of Member	Number of Members		Average Annual Benefit	
	<u>6/30/2012</u>	<u>6/30/2013</u>	<u>6/30/2012</u>	<u>6/30/2013</u>
Normal/Early Retirees	182,254	189,170	\$25,323	\$25,746
Survivor Annuity	11,455	11,469	\$9,731	\$10,394
Disability Retirees	<u>8,306</u>	<u>8,565</u>	\$17,604	\$18,384
Total	202,015	209,204	\$24,122	\$24,603

Age and Service Profile of All Active Members		
	<u>June 30, 2012</u>	<u>June 30, 2013</u>
Average Age	44.7 years	44.8 years
Average Years of PSERS Service	10.7 years	10.8 years
Average Annual Compensation	\$46,487	\$47,030

Class T-E Members		
	<u>June 30, 2012</u>	<u>June 30, 2013</u>
Number of Members	11,361	22,405
Average Age	35.6 years	35.9 years
Average Years of PSERS Service	0.4 years	0.7 years
Average Annual Compensation	\$21,254	\$22,573

Class T-F Members		
	<u>June 30, 2012</u>	<u>June 30, 2013</u>
Number of Members	1,531	3,496
Average Age	34.7 years	35.3 years
Average Years of PSERS Service	0.5 years	0.9 years
Average Annual Compensation	\$27,572	\$30,532

Section 1 - PSERS Overview

PSERS' Member Demographics and Economic Information (continued)

PSERS Pension Plan Changes in Net Assets 10 Year Cumulative Summary (Dollar Amounts in Millions)		
Cumulative 10 Year Total		
<u>July 1, 2003 - June 30, 2013</u>		
Balance of Net Assets (07/01/03)		\$ 42,316
Member Contributions	\$ 8,984	
Employer Contributions	6,783	
Net Investment Income	37,543	
Total Deductions - Benefits & Expenses	(46,612)	
Net Increase		\$ 6,698
Balance of Net Assets (6/30/13)		\$ 49,016

Cash Flow Fiscal Years Ended in June 30 (Dollar Amounts in Millions)			
	--- Projected ---		
	<u>2013</u>	<u>2014</u>	<u>2015</u>
Member Contributions	\$ 991	\$ 979	\$ 1,004
Employer Contributions	1,446	2,119	2,759
Total Contributions	\$ 2,437	\$ 3,098	\$ 3,763
Less:			
Pension Benefits	6,017	6,504	6,915
Negative Cash Flow	\$ -3,580	\$ -3,406	\$ -3,152
Beginning of Year Total Assets	\$ 48,534	\$ 49,016	\$ 49,316
Negative Cash Flow (NCF) as a % of Total Assets	-7.4%	-6.9%	-6.4%
Average NCF as a % of Total Assets (Public Funds)	-2.9%*		

*Based on the December 2013 Public Fund Survey prepared by NASRA.

Negative Cash Flow (NCF)

Using data from the table at the top of the page, the last 10 years of contributions and benefit payments resulted in a NCF of -\$30.8 billion during that time period. For the fiscal year ended June 2013, PSERS' NCF percentage is -7.4% which is more than twice the public fund average. Due to the projected increase in contributions through FY2014/2015, PSERS' projected NCF percentage declines to -6.4% but still remains over twice the -2.9% average of public funds*.

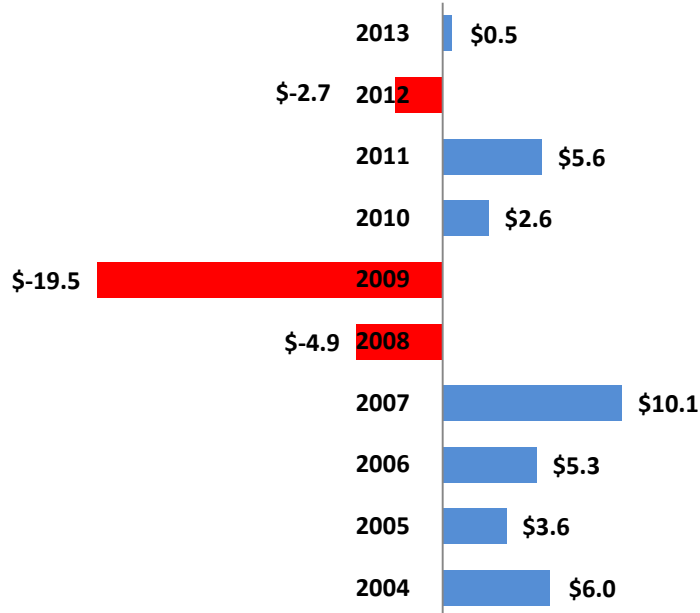
As a result of the large negative cash flow, PSERS has to sell a large portion of its investments each year to fund benefit payments. Consequently, even during years when

PSERS meets its investment return assumption, the Fund's assets will grow very slowly until employer contribution rates increase to the level recommended by PSERS' actuary. Regardless of PSERS's asset growth, the liability for pension benefits continues to grow each year. Without sustained asset growth PSERS unfunded liability will continue to grow until FY2018-2019 when contributions will be sufficient to begin to pay down the unfunded liability.

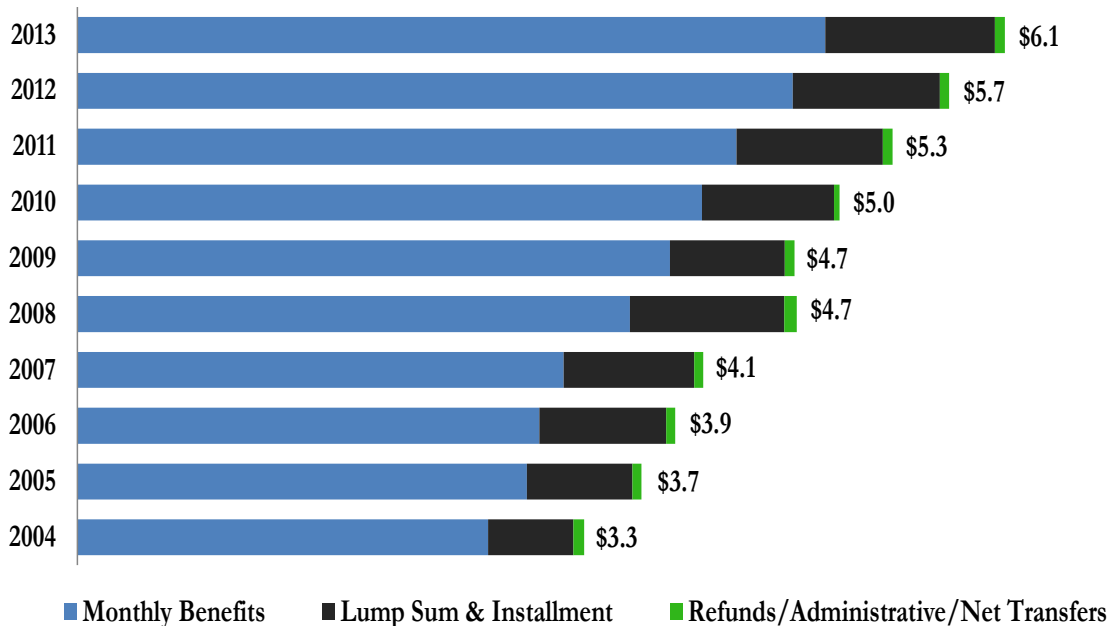
Section 1 - PSERS Overview

PSERS' Member Demographics and Economic Information (continued)

Net Increase/Decrease to Pension Plan Net Assets *
10 Year Trend (Fiscal Year Ended June 30)
 (Dollar Amounts in Billions)



Deductions from Pension Plan Net Assets*
10 Year Trend (Fiscal Year ended June 30)
 (Dollar Amounts in Billions)



*Does not include PSERS Postemployment Healthcare Plan Net Assets.

The Actuarial Process and Pension Plan Funding

PSERS is a defined benefit plan, meaning benefits are based on members' service and salary history. The following information highlights the actuarial process and funding for PSERS.

Actuarial Process

The actuarial process presumes that there will be a systematic flow of contributions at a specified level to pay for plan benefits and that the flow of contributions, together with investment earnings, will be sufficient to meet all benefit and expense requirements of the plan. Actuarial cost methods for funding PSERS pension plan are defined in the Public School Employees' Retirement Code. The actuary for the pension plan reviews economic and demographic experience annually and over five-year periods. The actuary's periodic valuations test the validity of the underlying actuarial assumptions versus the actual experience of the plan. That experience is also used as a basis for formulating actuarial assumptions about what will occur in the future with respect to salary growth, investment returns, and demographic factors such as rates of retirement and death.

Effective with the June 30, 2011 actuarial valuation, PSERS adopted several new demographic and economic assumptions as a result of the Five-year Experience Study completed by PSERS' actuary. PSERS' investment rate of return assumption was changed from 8.00% to 7.50%, the Salary Growth Assumption was changed from 6.00% to 5.50%, and new mortality tables were adopted.

Funding

The plan is funded through three sources: (1) employer contributions; (2) member contributions; and, (3) investment earnings. As depicted in the chart at the bottom of the page, for the ten-year period ended June 30, 2013 investment earnings provided 69% of PSERS' funding followed by 17% from members. Employers contributed 14%, the smallest of the three sources.

Employer Contributions

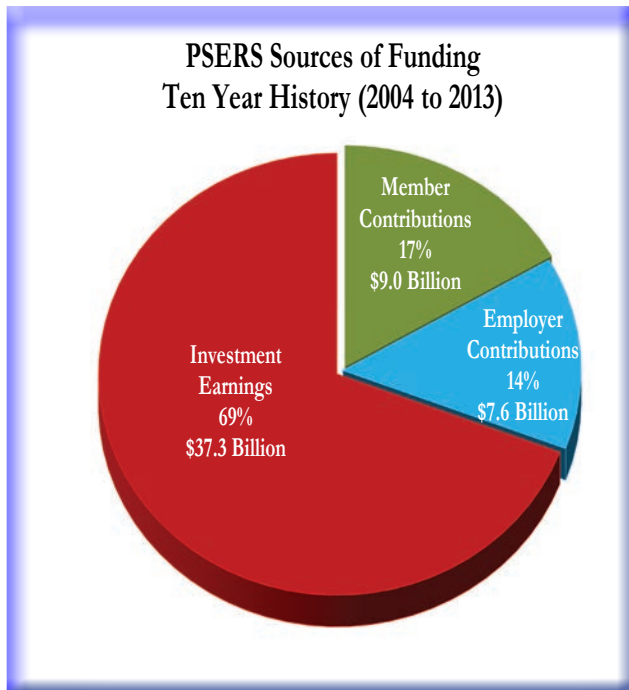
The Retirement Code vests the Board with the authority to establish the employer contribution rate (ECR). The Board, in consultation with the actuary, establishes the employer contribution rate annually, as part of the annual actuarial valuation. The employer contribution rate, which is expressed as a percentage of payroll, is composed of two items: (1) the pension contribution; and, (2) the contribution for health care premium assistance.

The total employer contribution rate for the fiscal year ended June 30, 2013 was 12.36%, including 0.86% for healthcare premium assistance. The total employer contribution rate for the year ending June 30, 2014 is 16.93%. This rate consists of an 16.00% pension rate (FY2012/13 pension rate of 11.50% plus the Act 120 4.50% collar) plus the healthcare premium assistance contribution of 0.93%. The FY2014/15 employer contribution rate is 21.40%. This rate consists of a 20.50% pension rate (FY2013/14 pension rate of 16.00% plus the Act 120 4.50% collar) plus the healthcare premium assistance contribution of 0.90%. The Board of Trustees certified this rate that was calculated in accordance with the provisions of Act 120 of 2010 at their December 2013 meeting. Without the Act 120 collar the employer contribution rate would be 26.87% in FY2014/15.

For the fiscal year ended June 30, 2013, PSERS' employer contributions totaled \$1.555 billion, which includes \$109 million for healthcare premium assistance. For the fiscal year ending June 30, 2014 the employer contribution estimate is \$2.230 billion, reflective of the 16.93% contribution rate. The contribution rate for the fiscal year ending June 30, 2015 is 21.40% which results in an employer contribution estimate of \$2.885 billion.

Member Contributions

Members of the Public School Employees' Retirement System who, prior to Act 9 of 2001, contributed to the Retirement Fund at the rate of 6.25% of their gross compensation, began contributing 7.50% in January of 2002, if they elected the higher retirement benefits. Members who contributed at the rate of 5.25% began contributing 6.50% if they elected the higher retirement benefits. The average contribution rate payable by the members for the current year (FY2013/14) is 7.43%.



**The Actuarial Process and Pension Plan Funding
(continued)**

In accordance with Act 120 of 2010, any employee who becomes a member after June 30, 2011 is a Class T-E member or, alternatively, can elect to become a Class T-F member. The base contribution rate for Class T-E members is 7.50% of compensation. The base contribution rate for Class T-F members is 10.30% of compensation. Class T-E and Class T-F members are subject to a “shared risk” employee contribution rate. The member contribution rate will stay within the specified range allotted for Class T-E or Class T-F, but could increase or decrease every three years starting July 1, 2015 depending on investment performance. Members now share a portion of the investment risk of the Fund giving PSERS a defined contribution element.

PSERS members contributed \$991 million for pension contributions for FY2013. Total member contributions are estimated to be \$979 million for the year ending June 30, 2014 and \$1.006 billion for the fiscal year ending June 30, 2015.

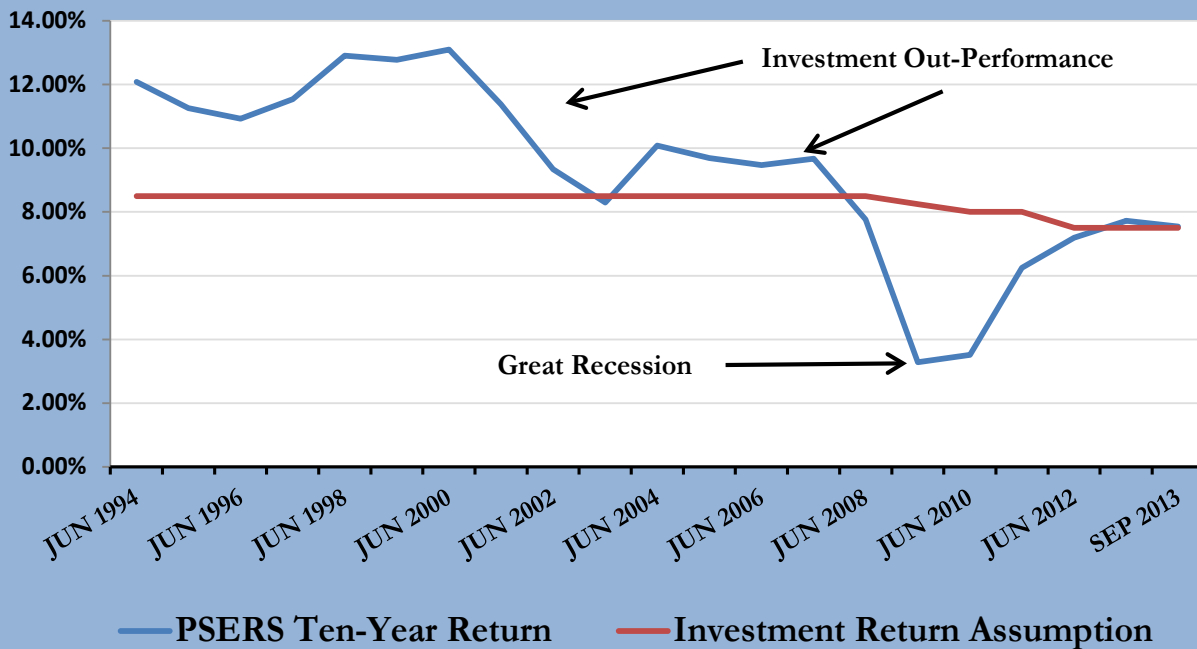
Investment Returns

The investment rate of return (net of fees) for the fiscal

years ended June 30, 2013 and June 30, 2012 was 7.96% and 3.43%, respectively. The annualized rates of investment return for the three, five and ten-year periods ended June 30, 2013 were 10.36%, 2.50% and 7.72% respectively. The investment rates of return for the one, three, five and ten-year periods ended September 30, 2013 were 6.99%, 8.94%, 5.53% and 7.54%, respectively. Over the past 25 years ended September 30, 2013 the Fund earned an estimated annualized rate of return of 8.71% which exceeded the Fund’s long term investment rate of return assumption during that time period.

PSERS’ ten-year return as shown in the chart at the bottom of the page has exceeded the actuarial investment rate of return for 15 of the last 20 years. Throughout much of the 1990s and 2000s PSERS investment performance exceeded its investment rate of return assumption. This outstanding investment performance resulted in declining employer contribution rates and/or contribution rates lower than the annual normal cost of benefits for most of those two decades. As a result of negative returns during the Great Recession, PSERS ten-year return dropped below the investment return assumption for several years. As a result of strong performance since the Great Recession, PSERS ten-year return once again exceeds its rate of return assumption.

PSERS Ten-Year Return From June 1994 Through September 2013 Compared to Investment Rate of Return Assumption



**The Actuarial Process and Pension Plan Funding
(continued)**

Funded Status

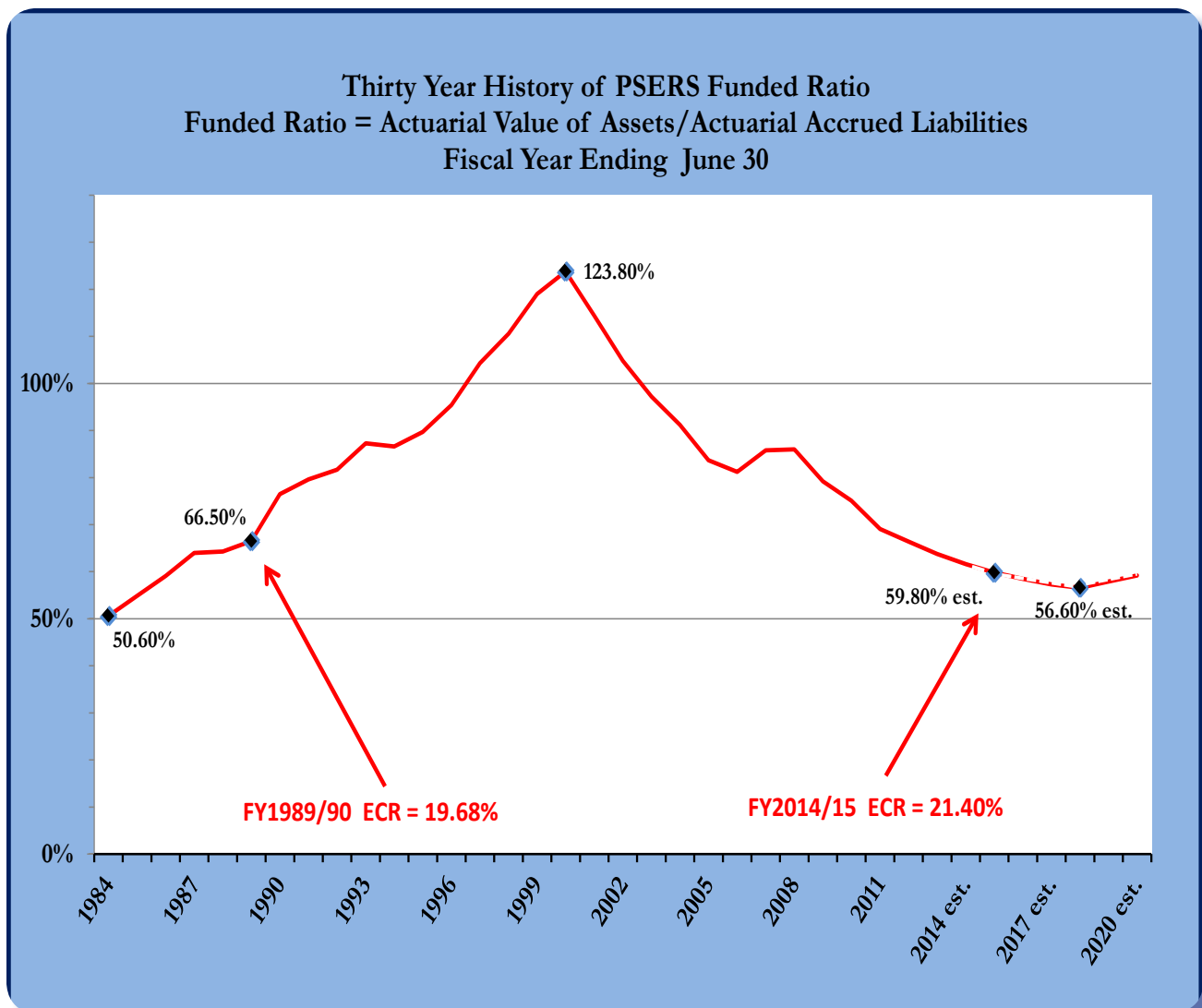
PSERS funded status is measured by comparing the actuarial value of assets with the accrued liability. The accrued liability is the present value of benefits accumulated to date for both active and retired members.

Key Facts

- Funded Status: 63.8% as of June 30, 2013
- Funded Status: 66.4% as of June 30, 2012
- The decrease in FY2013 is primarily due to the actuarial value of assets loss that occurred during the year as a result of the 10 year asset smoothing used

for actuarial valuation purposes and the continued underfunding of PSERS by its employers. As a result of Act 120, employers under funded PSERS by \$2.2 billion in FY2013.

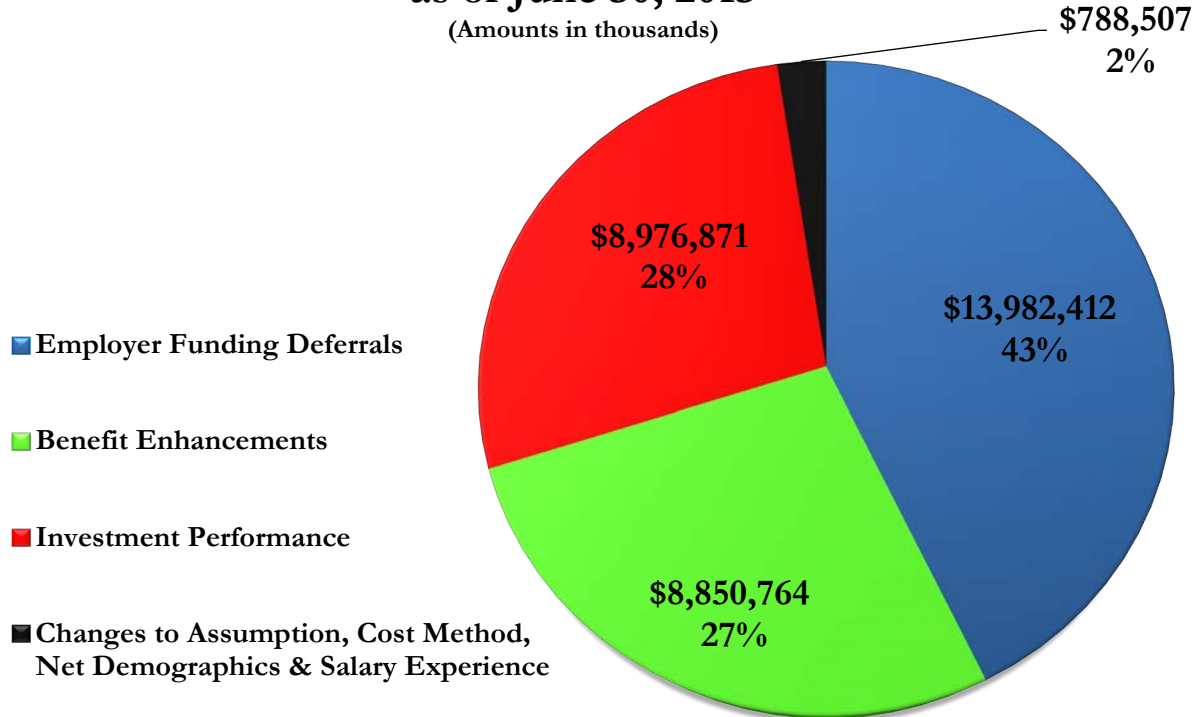
- The decrease in the funded status since 2000 is the result of several factors including: the unfavorable investment markets from FY2001 to FY2003 and FY2008 to FY2009; funding changes enacted in Act 38 of 2002 and Act 40 of 2003 which resulted in employers underfunding PSERS; the adoption of new demographic and economics assumptions in FY2008, FY2009 and FY2011; funding collars in Act 120 of 2010 which have continued the employer underfunding of the system; and, actuarial liability losses.
- A thirty-year history and seven year projection of PSERS' funded status is shown below.



**The Actuarial Process and Pension
Plan Funding
(continued)**

**PSERS Sources of Unfunded Liability Total - \$32,598,554
as of June 30, 2013**

(Amounts in thousands)



Sources of Unfunded Liability

The system's total funded ratio (for Pensions and Health Insurance combined) is 63.8% as of June 30, 2013. This funded ratio is based on an actuarial value of assets of \$57.5 billion and an accrued liability of \$90.1 billion which equates to a \$32.6 billion unfunded liability. The chart above depicts the sources of the unfunded liability. The largest sources of unfunded liability in order of magnitude are employer funding deferrals (43%), investment performance (28%), and benefit enhancements (27%), which include Act 9, cost of living increases and early retirement incentives. As a result of the Act 120 contribution rate col-lars, employer funding deferrals will continue to increase the unfunded liability for several years.

For many years PSERS' outstanding investment performance, which exceeded the investment return assumption, compensated for unfunded benefit enhancements and employer funding deferrals. The Great Recession eliminated the previous investment out-performance and reduced PSERS long-term investment performance which, as of

September 30, 2013, is now close to its return assumption. Without the investment out-performance to compensate, the employer funding deferrals and benefit enhancements have significantly increased PSERS unfunded liability. Seventy percent of PSERS June 30, 2013 unfunded liability is due to employer funding deferrals and benefit enhancements.

The Actuarial Process and Pension Plan Funding (continued)

GASB Pension Accounting and Financial Reporting Project (Pension Project)

In June 2012, the Governmental Accounting Standards Board (GASB) approved a pair of related Statements that reflect substantial changes to the accounting and financial reporting of pensions by state and local governments and pension plans. Statement No. 67, *Financial Reporting for Pension Plans*, addresses financial reporting for state and local government pension plans. Statement No. 68, *Accounting and Financial Reporting for Pensions*, establishes new accounting and financial reporting requirements for governments that provide their employees with pensions.

Statement No. 67 replaces the requirements of Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, for most public employee pension plans. Statement No. 68 replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, for most government employers. The new Statements also replace the requirements of Statement No. 50, *Pension Disclosures*, for those governments and pension plans.

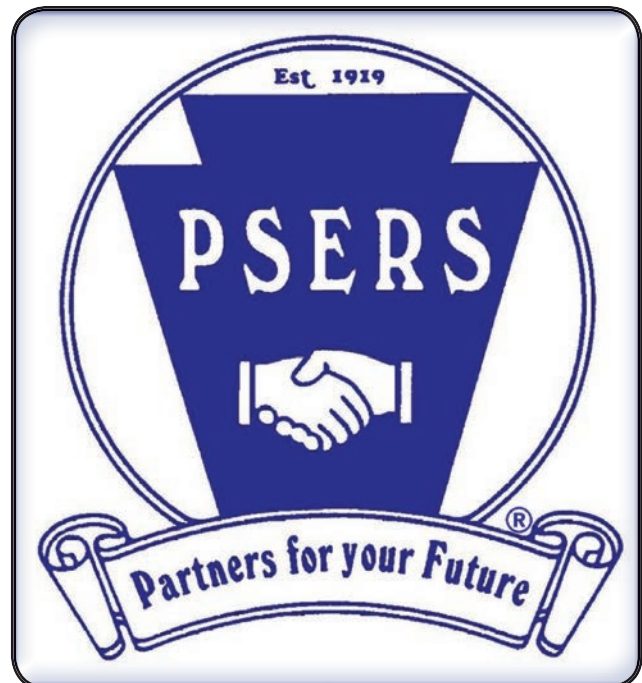
Statement No. 67 provides public employee pension plans such as PSERS guidance for financial reporting. Statement No. 67 will significantly change related financial reporting through note disclosures and new required supplementary information (RSI) schedules. These changes are necessary for government employers to comply with Statement No. 68.

Statement No. 68 will require cost-sharing governments (employers) to report a net pension liability, pension expense, and pension-related deferred inflows and outflows of resources based on their proportionate share of the collective amounts for all the employers in the plan. Additionally, all government employers participating in the plan will be required to include plan information in their note disclosures and RSI schedules.

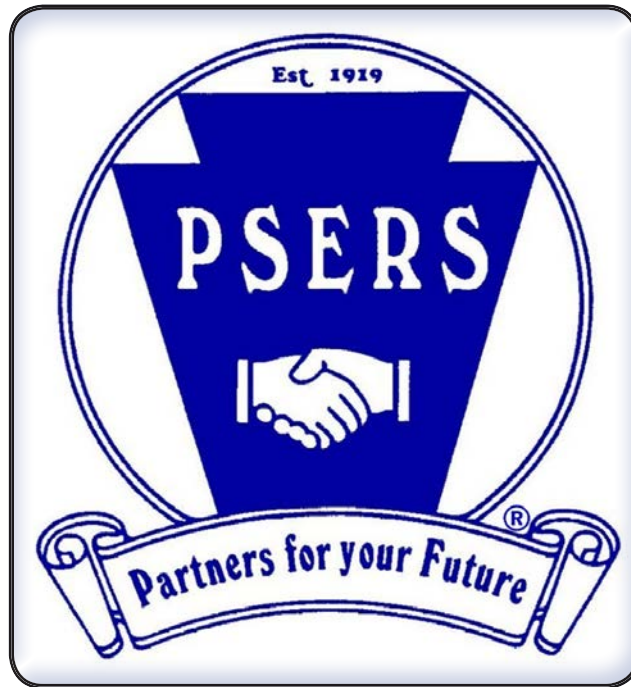
Statement No. 67 took effect for pension plans in fiscal years beginning after June 15, 2013. Statement No. 68 will take effect for employers and governmental nonemployer contributing entities in fiscal years beginning after June 15, 2014. Statements Nos. 67 and 68 are available for download at no cost from the GASB website, www.gasb.org. PSERS will implement Statement No. 67 and include Statement No. 68 disclosures for employers in FY2013/14.

Impact of Reducing Act 120 Rate Collars

The Governor's budget has proposed reducing the rate collars under Act 120 which will lower the employer contribution rate over the next five years. Under Statements No. 67 and 68, any reductions to the Act 120 collars will likely result in an increase to the unfunded accrued liability which must be reported in PSERS' financial statements and recorded as a liability on the balance sheet of PSERS' employers.



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Employer Contribution Rate

PSERS undergoes an annual independent actuarial valuation to calculate the actuarial assets and liabilities of the pension fund. Based on the actuarial valuation process, the actuary develops the recommended Employer Contribution Rate (ECR) that determines the employer contributions to the pension plan and healthcare premium assistance. The valuation process also measures the progress of the pension system towards funding pensions for its active and retired members.

Employer Contribution Rate Statistics

- Highest historical ECR (FY1985/86) 20.04%
- Lowest historical ECR (FY2001/02) 1.09%
- Ten yr. avg. ECR (2004/05 to 2013/14) 7.56%
- Twenty yr. avg. ECR (1994/95 to 2013/14) 6.82%
- Thirty yr. avg. ECR (1984/85 to 2013/14) 10.52%
- Adopted ECR (FY2014/15) 21.40%

PSERS' average member rate, employer contribution rate and normal cost for thirty years is presented in the graph on the bottom of the page.

Act 120 of 2010

Progress on Funding Issue

PSERS is in the 3rd year of a multi-year phase in of Act 120 of 2010. Act 120 provided historic pension reform and made dramatic progress toward addressing funding issues at PSERS. The legislation included actuarial and funding changes to PSERS and benefit reductions for individuals who become new members of PSERS on or after July 1, 2011. Members hired since the passage of Act 120 now total over 35,000 and account for 13% of the total active membership.

Impact of Benefit Cuts for New Members on or after July 1, 2011

For school employees who become new members of PSERS on or after July 1, 2011, there are two new classes; Class T-E and T-F.

Class T-E

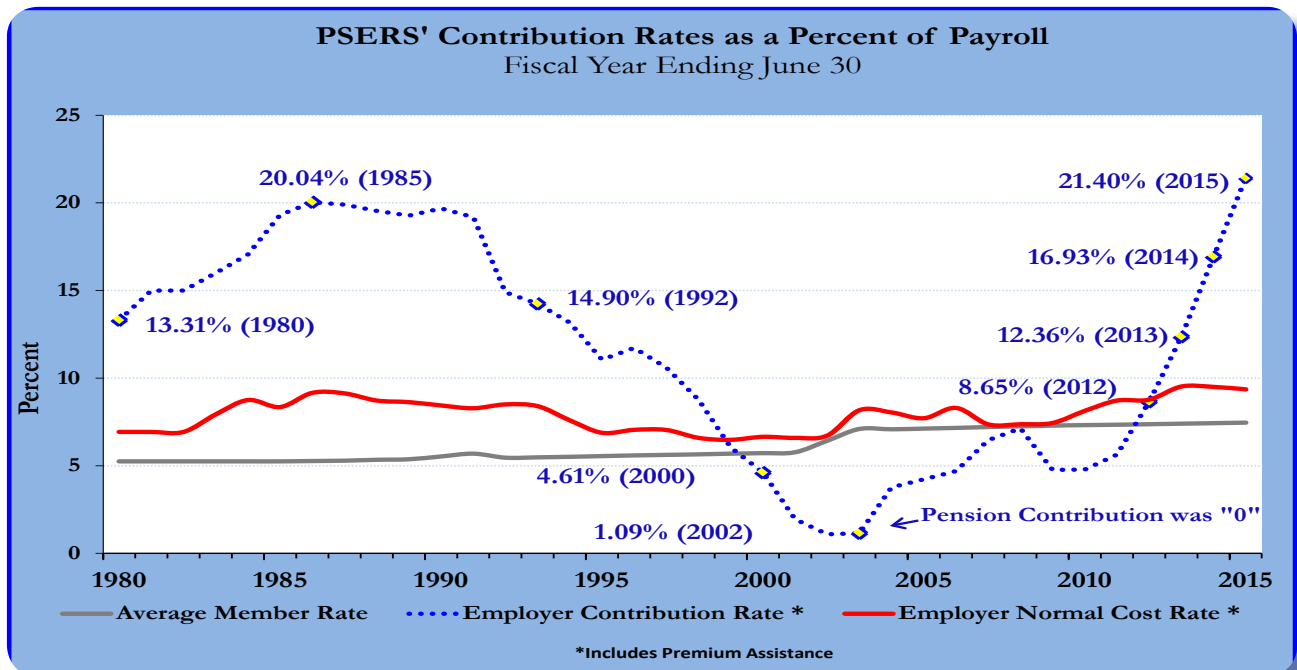
- Pension multiplier is 2%
- Effective July 1, 2011 employee contribution base rate is 7.5% (base rate) with "shared risk" contribution levels between 7.5% and 9.5%

Class T-F

- Pension multiplier is 2.5%
- Effective July 1, 2011 employee contribution base rate is 10.3% (base rate) with "shared risk" contribution levels between 10.3% and 12.3%

Class T-E and T-F members benefit when investments in the fund are doing well and share some of the risk when investments underperform. The member contribution rate could increase by .5% every three years starting July 1, 2015, depending on the investment performance of PSERS.

As of December 31, 2013, 4,638 or 13.3% of new members elected class T-F and 30,253 or 86.7% of new members remained in class T-E. As indicated above, Class T-F members maintain the higher 2.5% pension multiplier but contribute at a higher member contribution rate than Class T-E members.



Section 1 - PSERS Overview

Employer Contribution Rate

(continued)

Funding/Actuarial Changes Summary

Funding Changes - Employer Contributions

The legislation also suppressed the employer contribution rate by using rate caps in future years to keep the rate from rising too high, too fast for budgetary purposes.

The rate caps limit the amount the pension component of the employer contribution rate can increase over the prior year's rate as follows:

- FY2011/12 - not more than 3.0% plus the premium assistance contribution rate
- FY2012/13 - not more than 3.5% plus the premium assistance contribution rate
- FY2013/14 and thereafter - not more than 4.5% plus the premium assistance contribution rate

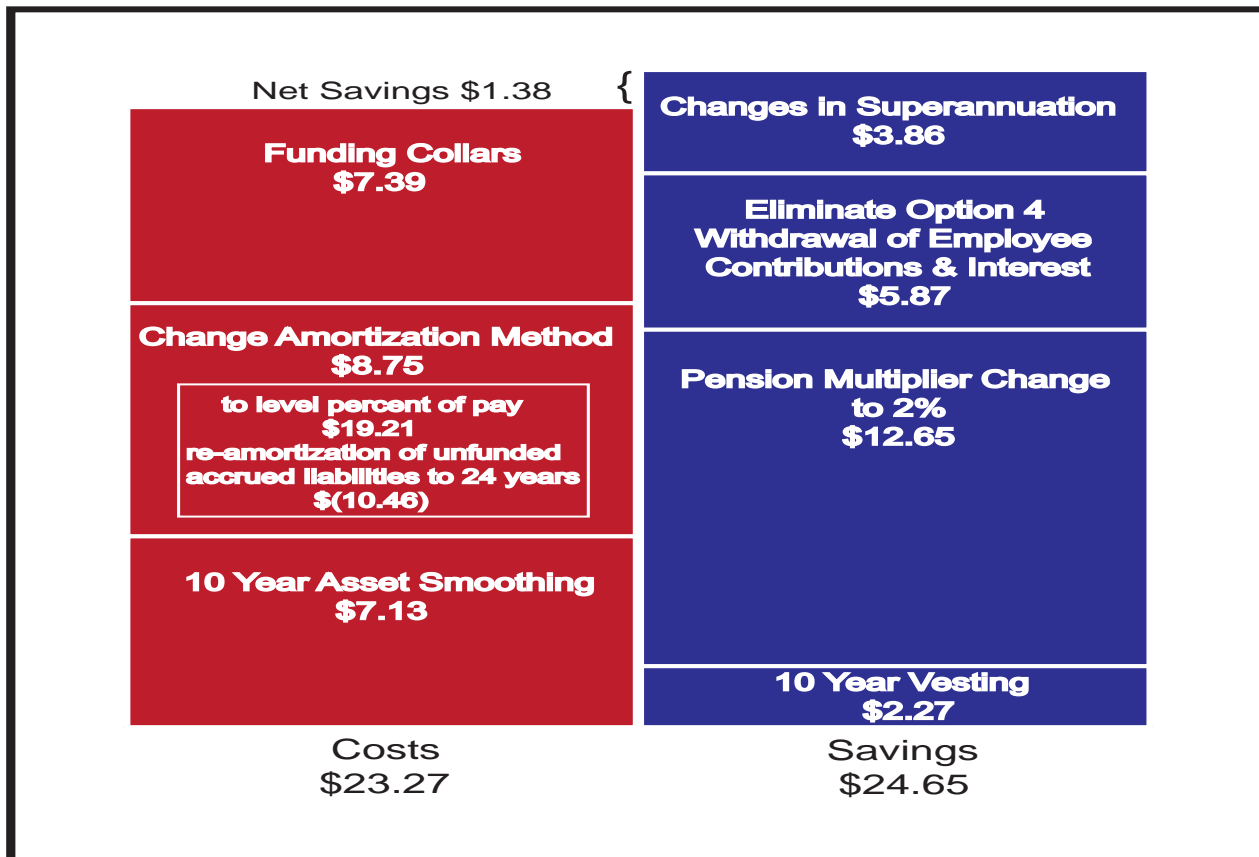
The rate cap remains at 4.5% until the rate cap no longer applies, i.e. the rise in the employer contribution rate is less than the rate cap in effect at that time.

After that, the rate is what is calculated by PSERS actuary and approved by the PSERS Board, subject to a new rate floor or minimum employer contribution rate that is the employer normal cost (currently about 8%), plus the premium assistance contribution rate. The "employer normal cost" is the amount needed from the school employers to fund the benefits earned by the active members for that year.

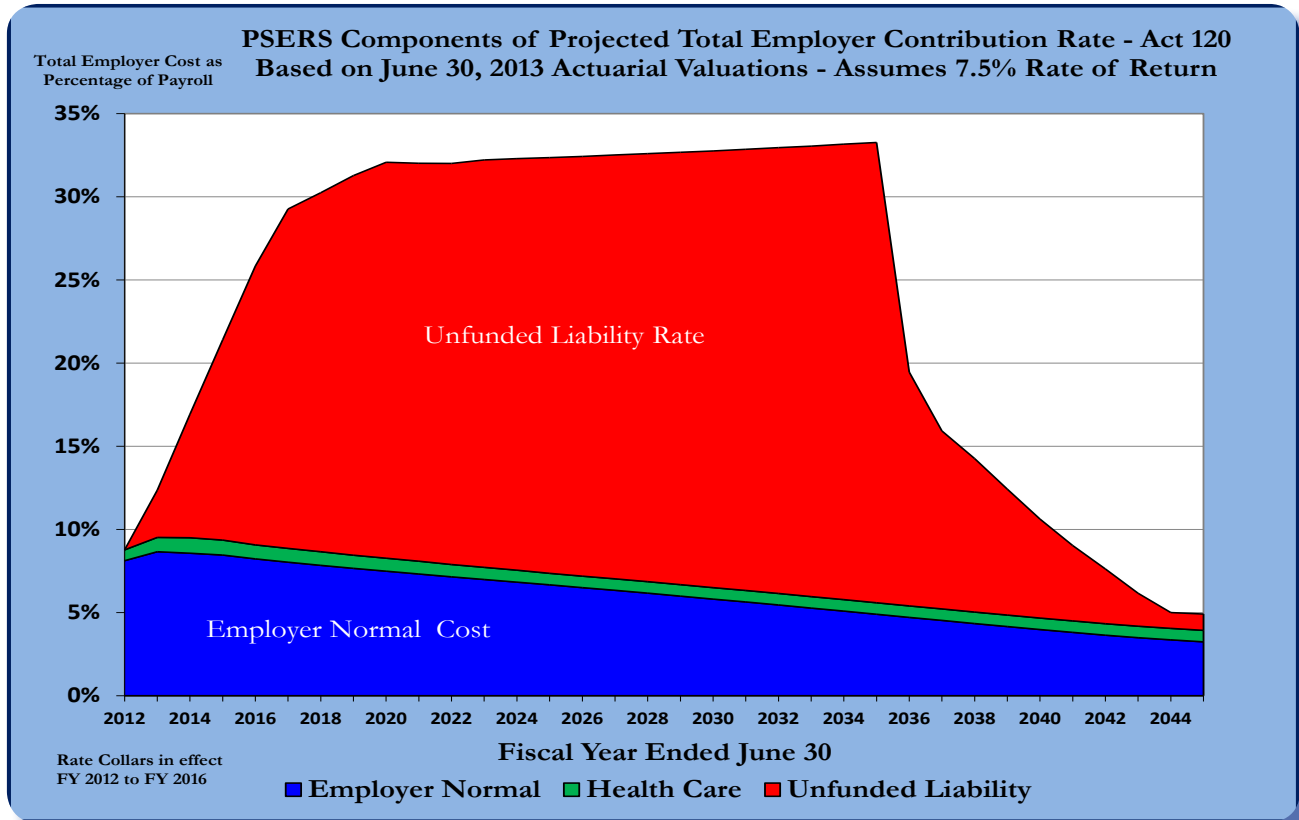
Act 120 Costs and Savings

As depicted by the chart below, Act 120 has a projected net savings of \$1.38 billion over 30 years. Act 120 benefit reductions are projected to save \$24.65 billion through FY2043/44. The cost savings from benefit reductions are offset by Act 120 funding and actuarial changes. Those changes defer contributions for budgetary purposes and are projected to cost \$23.27 billion through FY2043/44.

Act 120 of 2010 Costs and Savings Compared to Prior Law Projected to FY 2043/2044 (*\$ in billions*)



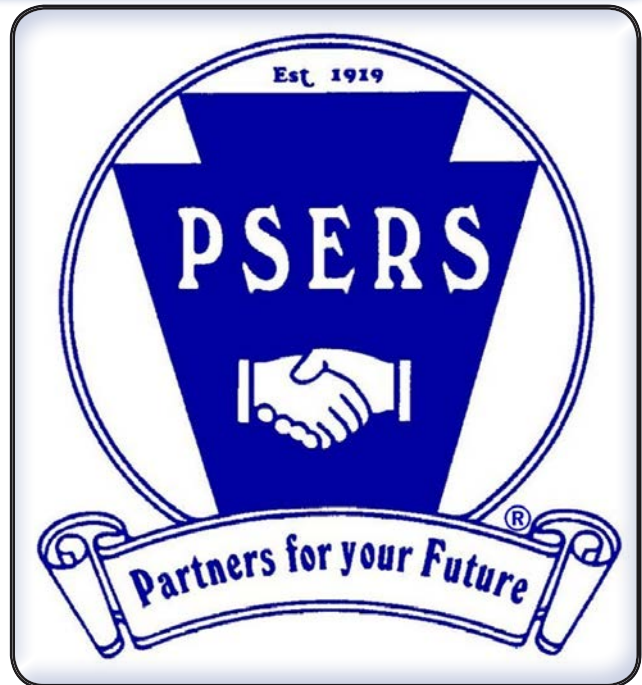
Employer Contribution Rate
(continued)



Act 120 Employer Costs

The cost structure of PSERS’ new members under Act 120 is low and the shared risk provisions shift a portion of the investment risk to active members giving PSERS a defined contribution element. The chart at the top of the page shows the components of the projected total employer contribution rate with unfunded liability, employer normal cost, and health care premium assistance. Essentially, Act 120 provides the members with a defined benefit plan, which is both adequate and secure, and provides the employers with a low cost employee pension benefit funded primarily by the members who have also assumed some of the investment risk. As the chart depicts, the employer normal cost decreases over time as Act 120 members replace retiring pre-Act 120 members. The employer normal cost of Act 120 members is less than 3% of payroll which is over 65% less than the normal cost for pre-Act 120 members. This represents a significant cost reduction for the employers.

Regardless of the benefit structure going forward, as depicted in the chart at the top of this page, the unfunded liability accumulated for service already rendered by active members is significant and represents a much larger cost to employers than the projected normal cost for existing and Act 120 members over the next 25 years.



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Section 1 - PSERS Overview

Employer Contribution Rate (continued)

Comparison of Projected Employer Retirement Contributions								
Pre-Act 120 vs. Act 120								
Fiscal Year Ending June 30	(A) Appropriation Payroll (in thousands)	(B) Employer Contribution Rates	(C) Pre-Act 120 Employer Contributions (in thousands)	(D)=(A)*(B) Act 120 Employer Contributions (in thousands)	(E)=(C)-(D) Budgetary Amount Deferred (in thousands)	(E)*56% (56%) State Share of Deferral (in thousands)	(E)*44% (44%) School Share of Deferral (in thousands)	% of GASB's Annual Required Contributions (ARC)
2013	\$12,836,000 *	12.36%	\$3,781,486	\$1,586,530	\$2,194,956	\$1,229,175	\$965,781	46
2014	\$13,174,000 *	16.93%	\$4,257,837	\$2,230,358	\$2,027,479	\$1,135,388	\$892,091	58
2015	\$13,482,000	21.40%	\$4,560,961	\$2,885,148	\$1,675,813	\$938,455	\$737,358	71
2016	\$13,841,530	25.84%	\$4,635,528	\$3,576,651	\$1,058,877	\$592,971	\$465,906	81
2017	\$14,214,689	29.27%	\$4,685,161	\$4,160,639	\$524,522	\$293,732	\$230,790	90
2018	\$14,613,842	30.25%	\$4,714,425	\$4,420,687	\$293,738	\$164,493	\$129,245	91
Cumulative Total Budgetary Deferral					\$7,775,384	\$4,354,215	\$3,421,169	

* Updated for most recent actual payroll.

Act 120 Budgetary Deferral

As indicated previously, the funding and actuarial provisions of Act 120 provided the Commonwealth and school employers a nine year period to appropriate funds for PSERS' unfunded liability. Act 120 will defer a total of \$7.8 billion in employer contributions from FY2012/13 through FY2017/18 as seen in the table at the top of the page. If Act 120 was not in place, the employer contribution rate would have spiked to 33.83% in FY2014/15 under previous law. That is an approximately \$1.7 billion dollar difference between the 33.83% Pre-Act 120 employer rate and the 21.40% employer rate that will go into effect July 1, 2014. The current FY2013/14 employer contribution rate of 16.93% also results in a \$2.0 billion reduction in employer contributions over the Pre-Act 120 contribution rate of 32.32%.

PSERS Annual Required Contributions

The schedule of employer contributions below shows historical trend information for the Annual Required Contribution (ARC) for pensions, and the percentage of the ARC contributed to the pension system. In addition, the Comparison of Employer Retirement Contributions table at the top of this page reflects projected ARC percentages through FY2017/18.

Depicted in the table below, as a consequence of the structural deficit in the Commonwealth's budget, the Commonwealth and school employers have not made the required annual payments to PSERS for the past eight years. Taxpayers, as a result, have benefited significantly from employer pension funding deferrals. However, bond rating agencies have already reduced Pennsylvania's bond

Schedule of Employer Contributions					
Year ended June 30	Annual Required Contributions (ARC)	Actual Employer Contributions	ARC Percentage Contributed		
2013	\$ 3,110,429	\$ 1,434,815	*	46%	
2012	\$ 2,629,244	\$ 1,001,140	*	38%	
2011	\$ 2,436,602	\$ 646,560	*	27%	
2010	\$ 1,928,278	\$ 527,212	*	27%	
2009	\$ 1,761,295	\$ 503,227	*	29%	
2008	\$ 1,852,238	\$ 753,532		41%	
2007	\$ 1,708,821	\$ 659,545		39%	
2006	\$ 1,328,373	\$ 456,878		34%	

* Net of purchase of service contributions.

Section 1 - PSERS Overview

Employer Contribution Rate (continued)

rating one time and pension funding was noted as one of the reasons for the decrease. Pennsylvania must continue to increase its contributions to PSERS as provided in Act 120.

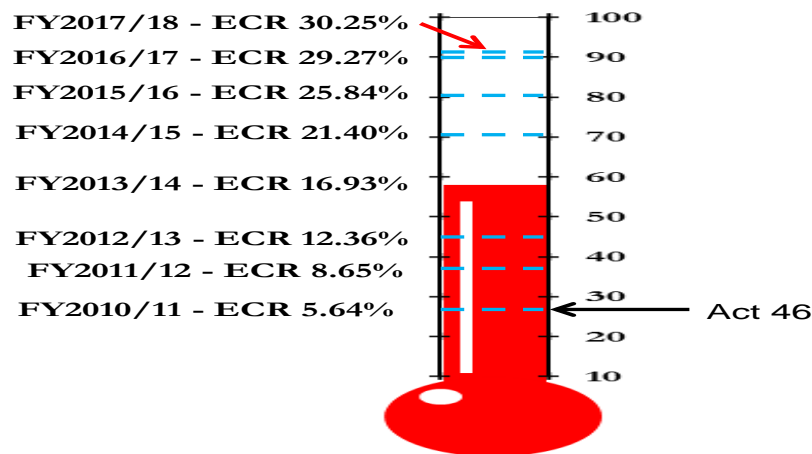
PSERS Board certified an employer contribution rate of 21.40% for FY2014/15 in compliance with Act 120. As a result, PSERS' ARC percentage is projected to increase from 58% in the FY2013/14 to 71% in FY2014/15. PSERS' projected ARC percentage of 58% for FY2013/14 is well below the average ARC percentage of 88% for public funds based on the December 2013 Public Fund Survey prepared by the National Association of State Retirement Administrators (NASRA).

The FY2014/15 contribution rate of 21.40% includes a portion to fund interest on the unfunded liability of the System. This will be the third consecutive year PSERS

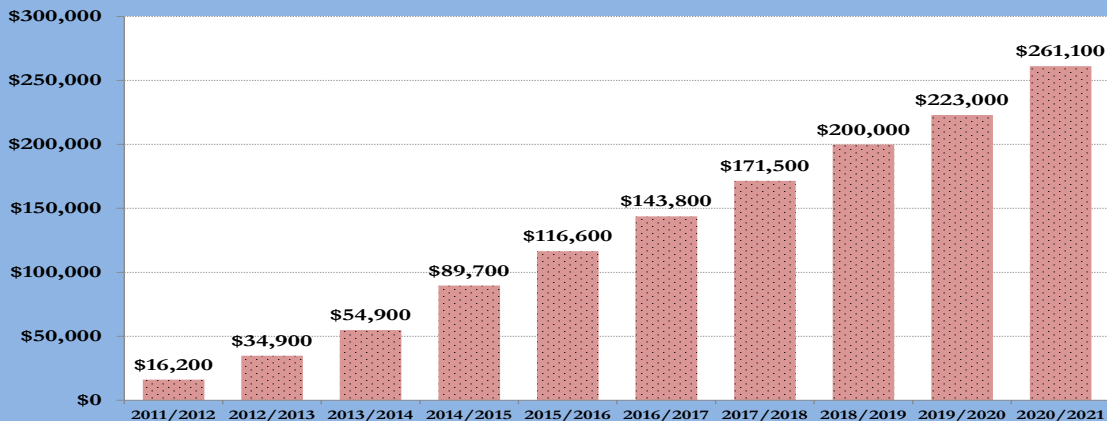
employer contribution rate includes a portion to pay for some of interest costs on the unfunded liability. As depicted in the thermometer chart below, the gradual rate increases under Act 120 are moving PSERS toward the 100% ARC goal. Rate increases implemented so far have moved the ARC from 27% to 58%. The funding provisions of Act 120 are working. Future projected contribution rate increases will raise PSERS' ARC percentage to nearly 90% by FY2016/17 which is slightly above the current average ARC of 88% for major public plans (NASRA).

The total estimated savings of the TE/TF Benefit Tiers is illustrated in the chart at the bottom of the page. As the number of TE/TF members grows, the savings from the low TE/TF cost structures also increases and will allow a bigger portion of employer contributions to go towards paying the unfunded liability.

ACT 120 Funding Progress PSERS Annual Required Contributions (ARC%)



Act 120 Total Estimated Annual Savings from TE/TF Benefit Tiers (ooo's omitted)



Next Steps

As noted, the Commonwealth and School employers have benefited over the past 8 plus years due to PSERS' very low ARC. Act 120 has significantly reduced the employer's normal cost for future new members via benefit reductions to new members, but a significant unfunded liability for service already rendered by active members still remains to be paid. As the chart on page 25 shows, even if PSERS only paid the unfunded liability, the employer contribution rate still peaks at over 20% of payroll and remains there for over a decade.

Act 120 has provided both the Commonwealth and the School employers with a nine year time horizon to gradually increase contributions to PSERS in a more budgetarily feasible manner than the contribution rate spike under previous law. The process is now an appropriation challenge to meet the gradual funding increases provided for in Act 120 and bring the ARC percentage to a healthy level and in line with other public pension funds.

On February 4th, 2014 during his budget address, Governor Corbett unveiled his plan for additional pension reform. At the time this Budget document was prepared, cost data for the Governor's proposal was not available. It is PSERS' understanding that this proposal would lower and reset the Act 120 rate caps on the employer contribution rate. As in the past, PSERS remains committed to providing all available assistance to the Governor, General Assembly and School employers to address the appropriation challenges.



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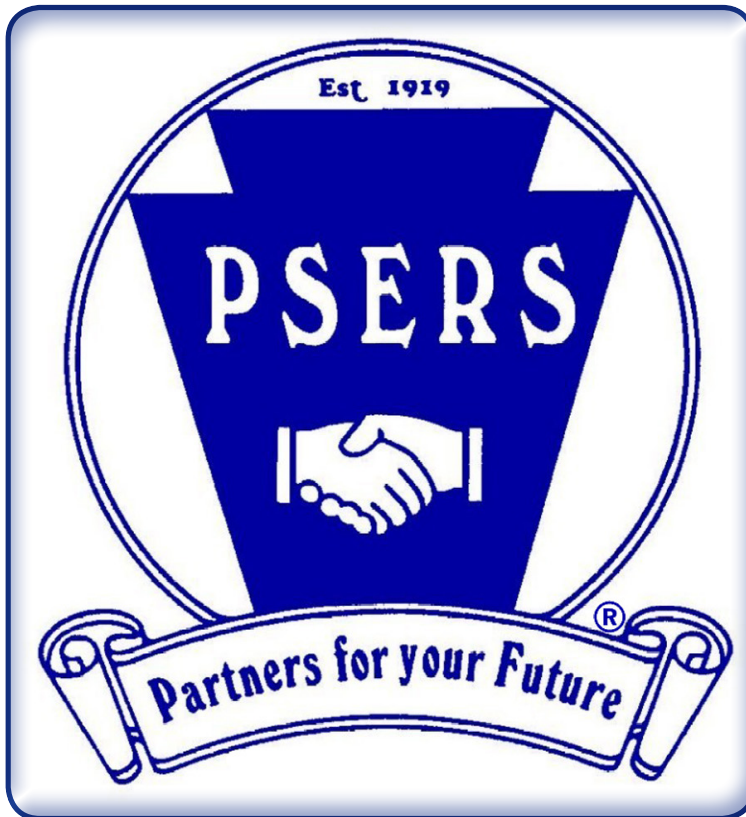
Section 1 - PSERS Overview

Consultants' Fees (\$50,000 and Over)

The following benefit, investment, information technology and financial professional service firms were under contract to provide services to PSERS during the fiscal year ended June 30, 2013.

<u>Firm</u>	<u>Services Provided</u>	<u>Consultant Fee</u>
CoreSource, Inc.	Postemployment healthcare benefits administration and claims adjudication	\$ 16,179,136 *
ViTech Systems Group, Inc.	Pension administration system services	\$ 5,205,228 *
Rx Solutions, Inc.	Administration of postemployment healthcare benefits and prescription drug plan	\$ 4,010,219 *
The Segal Company, Inc.	Actuarial services and consulting for the Health Options Program and prescription drug plan	\$ 2,359,018 *
Portfolio Advisors, LLC	Private market consulting	\$ 1,813,297
Aksia LLC	Hedge fund investment consulting	\$ 700,000
Financial Control Systems, Inc.	Investment accounting application service provider	\$ 635,104
Wilshire Associates	General investment consulting	\$ 624,474
Buck Consultants LLC	Pension benefit actuarial services	\$ 475,619 *
Independent Pharmaceutical Consultants, Inc.	Pharmacy benefit consulting services	\$ 391,800 *
Courtland Partners, Ltd.	Real estate investment consulting	\$ 258,750
Cutter Associates, Inc.	Investment processing and systems consulting	\$ 211,011
CliftonLarsonAllen LLP	Financial audit of pension system and postemployment healthcare programs	\$ 120,000 *
Glass, Lewis & Co., LLC	Proxy voting	\$ 92,062

* Amounts as reported in PSERS' Comprehensive Annual Financial Report.



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Legislation Information

PSERS Related Legislation Enacted during the Year 2013

FY 2013-14 BUDGET

PSERS ADMINISTRATIVE BUDGET: **HB 1278**, P.N. 2000

Appropriation amount \$41,689,000

Enacted by signature of the Governor July 9, 2013

ACT 2013 – 5A

EMPLOYER CONTRIBUTION: **HB 1437**, P.N. 2198

{ General Fund Budget Bill – Department of Education }

Appropriation amount \$1.017 Billion

Enacted by signature of the Governor June 30, 2013

ACT 2013 – 1A

AMENDMENTS TO RETIREMENT CODE PROVISIONS

HEART ACT/USERRA - This legislation was adopted to comply with federal law governing military leaves of absence, conforming PSERS pension law to the federal requirements directed under the Internal Revenue Code and the Uniformed Services Employment and Reemployment Rights Act.

SB 797, P.N. 1148 (amended the PSERS Code)

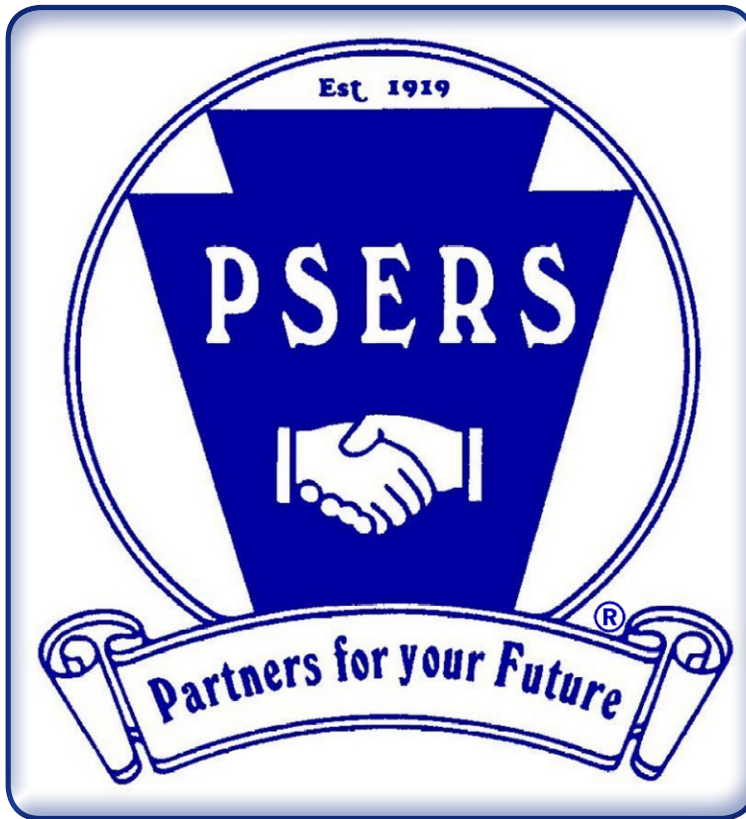
Enacted by signature of the Governor July 1, 2013

ACT 2013 - 32

SB 798, P.N. 818 (amended the Public School Code)

Enacted by signature of the Governor July 1, 2013

ACT 2013 - 33



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